For Distribution

Remarks of
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Federal Energy Regulatory Commission

"Order No. 2000: First Impressions as the Rubber Meets the Road"

Public Utility Research Center Annual Conference
Gainesville, Florida

February 25, 2000

I.

It is an honor to give the benediction to this Annual Conference of the Public Utility Research Center. It is likewise gratifying to wrap up what, by all accounts, has been a forward-looking discussion of the coming changes in the electric power business and how we can begin to come to grips with them.

When Bill Cavanaugh of Carolina Power & Light Company yesterday cautioned us all to be deliberative in our pursuit of industry changes and to be respectful

of history, it struck a chord. As a former professional historian, it is hard for me to find fault with that admonition. The problem is, nothing quite so dramatic as this has happened in this industry before, at least since Sam Insull.

Not so long ago, natural gas and electricity regulators felt no need for vision. Utility executives arguably had less need for strategy. The environment was relatively static, at least by comparison to today; and regulators, once a monopoly service provider had been selected, simply stood guard over its conduct forever. There was an understanding about cost recovery between government and these energy providers called the regulatory compact, and precedent became the regulatory bible. While there were varying interpretations of the canon, nothing made it necessary or desirable to stray from the faith.

As an indication of the sheer dimension and pace of the challenges we suddenly face, when a Committee of the Florida House of Representatives recently issued a primer on the state of the industry, it took less than two pages to dispose of everything from young Edison to the 1992 Energy Policy Act. The weighty discussion of what has occurred in less than a decade since then barely scratches the surface of what the current complex circumstances are. Much as we might prefer "careful study to raw speed" in approaching the challenges of competitive energy markets, I don't think we get to choose. We must do both. Regulators and industry alike must be prepared to make fundamental, difficult, and altogether historic decisions in the next five years about how competitive energy markets will work and how the public interest is served. Most of the tough decisions of the next few years still belong to the states. In Florida, the premium on courage and collaboration, as well as care and speed, is as high as it is anywhere else. As they say, you can run but you can't hide! Neither can we in Washington.

It is widely acknowledged that the demand for electricity will increase 30 to 40 percent in the coming decade. Florida alone needs to more than double its generation resources by 2004. Gas companies are eagerly, and also apprehensively, anticipating a 30 or 35 Tcf market for natural gas in ten years, one third greater than 10 years ago nationally and many times that here in Florida. In an environment where building gas transmission facilities is usually seen, at least presently, as less problematic to build than electric transmission, there are serious questions about how the new electric load will be met, and met reliably. Part of the answer emerging around the country appears to include more merchant generators, retail choice

programs, and new incentives to upgrade transmission and delivery systems.

The impetus for change does not stop there, however. The overwhelming and sudden emergence of e-commerce is changing our techniques of supplying all kinds of services, including energy, and making available to companies and consumers new ways to purchase, configure and manage products, including energy. I submit to you that the Internet will change the way customers think and act, and it may render strangely outdated, if not irresponsible, any obstacles placed by utilities or governments to customer choice. Yet, Business Week (October 11, 1999) reports that utility spending on e-commerce is the lowest of all major business sectors. To put it more bluntly, the Economist states that companies that do not embrace the Internet will experience "death by 1,000 clicks."

All over the country, utilities are searching for ways to respond to these pressures to compete, to reposition themselves for a new environment or -- to put it another way -- to create or realize greater value from new combinations of assets and services. Energy mergers accelerated in 1999; there were thirty compared to ten for 1998 and seven for 1997. More of them involved the convergence of gas and electric companies, mergers of traditional utilities with non-traditional players, mergers with foreign firms, and alliances with non-energy firms. We saw the first mergers of disaggregated "T and D" companies. Finally, electric utilities are more often making the business decision to separate the dividend-driven component of the business, transmission and distribution -- from the growth and often less regulated side of the business, generation or telecommunications -- in the belief that the pieces are worth more than the whole. Recent

auctions of generation units at multiples of book value seem to bear that out.

II.

It is in this broad and dynamic context that the Commission issued Order No. 2000. Naturally we got down to the specifics of how Regional Transmission Organizations can address undue discrimination in the provision of transmission service, enhance reliability and market transparency, and how they will produce greater efficiencies through competition and regional planning. But, make no mistake about it, we believed strongly that the bulk power market, as it now exists, would not be up to the challenges of the 21st century unless it was reconfigured on a new foundation. The RTO, or at least regionalism, was not a new idea in December of last year. NERC has embodied it for almost 40 years. Regional coordination was a major part of

the 1992 legislative debate, and we've been dealing with how to create broader wholesale markets ever since, especially in light of Order No. 888 open access.

Yet, the need is now much greater to enhance system reliability, develop better congestion management, overcome obstacles to rational transmission planning and expansion, create markets that all players can trust, and encourage development of new generation where needed, not to mention the need to support emerging retail access programs. I believe you feel that need as keenly here as anywhere else.

RTOs are not the entire answer, of course. But without them, policymakers and business decisionmakers will find the solutions to the new market challenges very hard to attain indeed. Our rule is voluntary. But we are serious about seeing it implemented. What

has been said here in Gainesville makes me optimistic, and I know that the FERC owes a great deal to the early effort of the Florida PSC to promote discussion about the future of this market. We are quite clearly moving toward a shared vision of what grid operations and the wholesale market as a whole can become. With RTOs of proper scope and configuration, operational authority, and independence from market participants, we can fashion a transparent, reliable bulk power system that ends the balkanization and inefficiency that were so acceptable for so many years and now promise us only grief.

The Commission has put itself and its resources on the line. We are beginning a collaborative process that will carry through the spring and summer and up to the October 15 filing deadline. We are making staff available all over the country to consult, advise, and facilitate <u>without</u> being prescriptive. We are looking

for regionally appropriate solutions, and we will return the creativity and hard work of participants not only with better markets, but with better (and even less) regulation, deference, and pricing reforms to support the viability of the new stand-alone transmission business. Staff has already begun its work in the Pacific Northwest, where the Bonneville Power Administration and the major utilities have committed to work with all participants on an RTO. It's now on to Cincinnati and the Midwest next week. We want all states and regions and market participants involved, working, talking, and getting down to the details.

III.

As often happens in negotiations, especially where preconceptions are powerful, parties will enter the process with bottom-lines, with assumptions that have

not borne examination, or a willingness to go "just so far." Like any other state or region, Floridians no doubt bring similar baggage to the table as well, perhaps for good reason.

Let me close with a few point-counterpoints to let you know that participants in your state processes or our collaboratives (and they are not mutually exclusive) ought to be prepared to critically reexamine their preconceptions. We have heard them all before.

Point: Public power entities won't participate in an RTO.

Counterpoint:

They have special issues, but experience thus far shows that a viable offer will do the job of moving parties toward a common goal. The New York Power Authority and the Long Island Power Authority have joined an ISO in New York, BPA is working on a big

one out West, and the Georgia cooperatives could be eager partners for you. But, as Hagler Bailly said in its <u>Outlook 2000</u>, the problem may be that "a monopoly IOU and a monopoly publicly owned entity have much more in common than either wants to admit." Where disaggregation has occurred, the potential for real partnership between private and public power is greater.

Point: No one-size-fits-all solutions from Washington.

Counterpoint:

Okay, we give up! Order No. 2000 affords regions enormous flexibility as long as voluntarism can be made to produce. We have rejected proposals that do not meet our basic requirements because the defects undermined the fundamental objective of a large unbalkanized market for bulk power. But

within that parameter, we are open to a breathtaking range of proposals.

Point: Incentives only work where for-profit institutions, normally transcos, are formed.

Counterpoint:

Behavior and rewards can be linked in any organization. After all, the stock exchanges have nonprofit boards. Besides, the Commission has already shown a willingness to entertain hybrid or multi-tiered organizations that can effectively function and obtain the attributes of more than one form of RTO.

Point: Ownership and control of transmission cannot be efficiently separated.

Counterpoint:

Existing ISOs have proven that assumption incorrect. Properly structured, ISOs (like transcos) can have an incentive to maximize throughput, be accountable, and identify opportunities. More basically, separating ownership and control is the quickest way to obtain a form of operational independence for the grid. Transcos have proven tougher to put together and pose special problems for public power entities. Order No. 2000 allows ISOs to evolve into transcos, and we even approved that idea in Alliance. The <u>real</u> problem is not the combination of ownership and control of transmission, but the combination of generation and transmission that results from vertical integration.

Point: Stakeholder boards are inefficient and possibly unfair.

Counterpoint:

Maybe so. That particular form of democracy has not been without its problems. However, they do add value to the extent they help avoid litigation and build trust among market participants.

Point: A Florida-only RTO is the only practical option.

Counterpoint:

Believe me, every region thinks it is unique and it's generally not. If any State (other than Alaska or Hawaii) is electrically isolated, it is Florida. There is a better (but not conclusive) argument to be made that Florida is a more discrete "region" than there is for New York or California. Only up to 10 percent of Florida's demand can be satisfied by electricity imports; so, gas, oil, and coal must be imported instead. But, why is this

existing situation good? Without a cross-border RTO, Florida may lose low-cost options for its consumers. An RTO can help strengthen interties and expand the market available to Florida consumers. In an e-commerce environment where all regions are competing for capital, going it alone could be costly. Moreover, I cannot commit that a Florida-only RTO meets the requirements of Order No. 2000.

In sum, if the participants in this market want to move ahead, these are solvable problems. Don't use them as excuses or ways to foreclose good discussions or take off the table good options that may, now or in the future, lead to greater inclusion of participants in the market -- the test of a successful and competitive market. My colleagues and I look forward to seeing the fruits of your hard work . . . soon! And we are available to lend a hand whenever you need it.

Thank you